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IN THE

Supreme Court of the United States

October Term 1980.

CHESTER C. DAVIS, DAVIS & COX, MAXWELL E. COX, HOWARD M. JAFFE, and D. MARTIN COOK,

Petitioners,

vs.

SUMMA CORPORATION, HUGHES PROPERTIES, INC., and HUGHES AIR CORP.,

Respondents.

Response to Petition for Certiorari to the United States Court of Appeals for the Ninth Circuit.

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Respondents.

Response to Petition for Certiorari to the United States Court of Appeals for the Ninth Circuit.

The Respondents, SUMMA CORPORATION, HUGHES PROPERTIES, INC., and HUGHES AIR CORP., respectfully pray that a writ of certiorari not be issued to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on March 16, 1981.

Opinion Below.

The memorandum opinion of the Court of Appeals, which is unpublished, appears in Appendix A to the Petition for Writ of Certiorari. No opinion was rendered by the District Court for the Central District of California.

Statement of the Case.

Davis and Cox filed this action in the United States District Court for the Central District of California to recover legal fees and costs allegedly owed to them by Summa Corporation. Summa, along with Hughes Air Corporation and Hughes Properties, Inc. (hereinafter referred to as "Summa"), then filed counterclaims concerning a series of improper activities which occurred during the ten-year period prior to the death of Howard Hughes. The second amended counterclaims, the subject of this action, are posited on undue influence, and breach of contractual and fiduciary duty.

Count One alleges that the counterdefendants conspired to gain control of Hughes' corporate and personal assets, and once they were in control, they misappropriated those assets for their personal benefit. This claim is grounded on breach of the fiduciary duties owed to Hughes, and breach of contractual duties of fairness and good faith. Counts Two and Three claim that excessive employment and consulting contracts for the counterdefendants were entered into and approved of in breach of fiduciary duties owed to Hughes and Summa. Count Two alleges that the directors of Summa approved their own contracts and Count Three alleges that the contracts were approved pursuant to the conspiracy. Count Four claims that the counterdefendant directors are liable for acts of waste, mismanagement, and negligence performed in connection with their operation of Summa. The claim is grounded on breach of fiduciary duties. Count Five is directed toward the attorneys and primarily alleges legal malpractice and breach of the fiduciary and implied contractual duties owed to Hughes and Summa. Count Five also alleges that the attorneys' actions were part of the conspiracy. Despite the fact the second amended counterclaims are not posited on fraud, the District Court dismissed

them, under Rule 9(b) of the Federal Rules of Civil Procedure for failure to plead fraud with sufficient particularity. This erroneous dismissal was with prejudice, and was entered pursuant to Rule 41(b). The order was then entered under Rule 54(b) as a final judgment of dismissal against Summa. Shortly thereafter, the trial court enjoined respondents from pursuing its counterclaims in a similar action then pending in Nevada state court.

On March 16, 1981, the Ninth Circuit reversed the judgment of the trial court, finding that the dismissal was improper. This decision was grounded on the finding that none of the allegations in the counterclaims constitute a common law fraud claim. The court further found that even if Rule 9(b) were applicable, the counterclaims more than satisfy the dictates of Rule 9(b) (Petition for Certiorari, Appendix A — hereinafter referred to as "Opinion Below" — at 6).

Reasons the Writ Should Not Be Granted.

A. The Requirements of Rule 9(b) Do Not Apply to the Instant Case.

The court below correctly holds that the allegations contained in Summa's second amended counterclaims do not constitute a common law fraud claim. Rather, they are allegations of undue influence, and breach of fiduciary and contractual duty (Opinion Below at 3-4, 6). The court below does not assert that the allegations have penetrated the ill-defined penumbral area surrounding common law fraud; rather, it merely suggests that, to the degree the allegations *could* be so viewed, they nevertheless more than satisfy the

dictates of Rule 9(b) (Opinion Below at 6).[1] The court was correct in this analysis; Summa has met and exceeded the most stringent requirements of particularized pleading, even though Rule 9(b) is not actually applicable to the instant case. The determinative fact, however, is simply that Rule 9(b) is inapposite, given that the second amended counterclaims are not based on allegations of fraud. Indeed, petitioners do little to rebut this finding (Petition for Certiorari — hereinafter referred to as "Petition" — at 6). It would thus be inappropriate for the court to grant certiorari merely to examine the Ninth Circuit's discussion of Rule 9(b) in this case, given that the discussion is essentially dicta.

B. There Is No Conflict Among the Circuits in the Application of Rule 9(b).

In the instant case, no important questions in the administration of the Federal Rules of Civil Procedure are presented. Despite petitioner's assertion to the contrary (Petition at 6), there is no divergence in the circuit's application of the particularity requirement of F.R. Civ. P. 9(b). Indeed, the differing outcomes evidenced in the Ninth, Seventh, and Second Circuit cases cited by petitioner are not caused by a difference in interpretation of the particularity requirement, but rather by the differing factual patterns in the cases themselves. Therefore, certiorari is inappropriate.

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[1]Though Summa's second amended counterclaims do allege undue influence, and breach of fiduciary and contractual duty, they do not allege fraud. The pleading requirements for non-fraud claims differ from those sounding in fraud. For example, in *Spiegler v. Wills*, 60 F.R.D. 681 (S.D.N.Y. 1973), after dismissing a second amended complaint (with leave to replead) for failure to satisfy the 9(b) particularity requirement, the court noted, "If this were a civil case other than one posited on fraud — such as a claim sounding in negligence, or breach of fiduciary duty — the requirement for a sufficient pleading would be quite different." *Id.* at 683. Similarly, the Rule 9(b) particularity requirement does not apply in the instant case, which is not based on fraud.

Petitioners cite *Bosse v. Crowell, Collier, and MacMillan*, 565 F.2d 602 (9th Cir. 1977); *Tomera v. Galt*, 511 F.2d 504 (7th Cir. 1975); and *Walling v. Beverly Enterprises*, 476 F.2d 393 (9th Cir. 1973) for the proposition that the Ninth and Seventh Circuits maintain a "lax approach" as to what the particularity requirement really means. (Petition at 6). However, in each of these cases the circumstances constituting fraud were specifically pleaded. As stated by the Ninth Circuit in *Bosse*, "While mere conclusory allegations of fraud will not suffice, statements of the time, place and nature of the alleged fraudulent activities will." *Bosse, supra*, at 611. This is far from a lax approach. For example, in *Bosse*, plaintiffs maintained a securities law claim, based in part on section 10(b) of the 1934 Securities Exchange Act (15 U.S.C. §78j(b)) and Rule 10b-5 thereunder (17 CFR §240.10b-5). The "manipulative or deceptive device" alleged in this claim was defendants' establishing a debtor-creditor relationship with plaintiffs via a loan and pledge arrangement, with the underlying intent or purpose of gaining control of plaintiff's company. *Bosse, supra*, at 611. The transactions in question were pleaded with specificity as to time, place, content, and parties. *Id.* at 605-06. So too in *Walling*, another case involving fraudulent intent, plaintiffs similarly pleaded a specific fraudulent transaction. *Walling, supra*, at 395. In the Seventh Circuit case, *Tomera*, involving fraudulent misrepresentations, the plaintiff recited the date and express content of the false statement made by defendant president of a mining company concerning the existence of the company's mining operations. *Tomera, supra*, at 508. Given these facts, it is difficult to see how the courts were lax in holding that plaintiffs satisfied the particularity requirement of Rule 9(b).

These cases have a striking factual contrast to *Denny v. Barber*, 576 F.2d 465 (2nd Cir. 1978) and *Segal v. Gordon*,

467 F.2d 602 (2nd Cir. 1972), cited by petitioners as examples of a "stricter approach". (Petition at 6-7). In both of these cases, no specific transactions were pleaded. *Denny, supra,* at 469; *Segal, supra,* at 608. It is no surprise that the Second Circuit held that "[u]nder the circumstances, such a pleading does not 'give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests.' " *Denny, supra,* at 469. Indeed, the same fair notice criteria is applied in the Ninth and Seventh Circuits. *See Bosse, supra,* at 611; *Tomera, supra,* at 508, *Walling, supra,* at 397. When fraud is alleged, specificity is required to satisfy the fair notice requirement; this is because fraud embraces such a wide variety of potential conduct that a defendant needs a substantial amount of particularized information about plaintiff's claim in order to enable him to understand it and effectively prepare his response. *See* 5 *Wright and Miller, Federal Practice and Procedure* §1296, at 400 (1969). Thus, the specificity standard, while serving the major purpose of Rule 9(b) of giving adequate notice of plaintiff's claim of fraud, is in harmony with Rule 8, which requires that averments in pleadings be concise and direct. *McGinty v. Beranger Volkswagen, Inc.*, 633 F.2d 226, 228 (1st Cir. 1980).

The specificity standard also serves other purposes, one of which is the protection of the defendant's reputation or goodwill, when charged with serious wrongdoing. *Ross v. A.H. Robins Co.*, 607 F.2d 545 (2nd Cir. 1979), cert. denied 446 U.S. 946 (1980). However, there is no conflict between the purposes of fair notice and protection of reputation (Petition at 8). Indeed, in *Ross* itself, the Second Circuit emphasized the fact that a defendant is entitled to a "reasonable opportunity to answer the complaint and must be given adequate information to frame a response." *Ross, supra,* at 557-58. The court then went on to evaluate the

complaint using this criteria. Thus, satisfaction of the fair notice requirement itself serves to protect the reputation of the defendant by requiring plaintiffs to supply a factual basis for their allegations regarding defendants' knowledge.[2] Similarly, in *United States ex rel. Joseph v. Cannon*, 642 F.2d 1373 (D.C. Cir. 1981) the court held that the requirement that the pleader state the time, place, and content of false representations, while serving the purposes of discouraging nuisance suits and frivolous accusations of moral turpitude, also guarantees "all defendants sufficient information to allow for preparation of a response." *Id.* at 1385.[3]

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[2]In *Ross*, the Seventh Circuit held that plaintiff must specifically plead those events that give a strong inference that the defendants had knowledge of the health risks endemic in their product, the Dalkon Shield contraceptive device, and the time that they obtained that knowledge. *Ross v. A.H. Robins Co.*, 607 F.2d 545, 558 (2nd Cir. 1979), cert. denied 446 U.S. 946 (1980). This is entirely consistent with *Tomera v. Galt*, 511 F.2d 504 (7th Cir. 1975), for in *Tomera*, the plaintiff alleged that the president of the mining company made statements that the company held valid mine leases and that it was carrying on silver mining operations, neither of which was true. By alleging that the statements were made by the company president, the existence of the knowledge of company operations was implicit. In *Ross*, on the other hand, it was not evident that the defendants were aware of the health risks endemic to the Dalkon Shield at the time alleged. Therefore, greater specificity was required to give defendants adequate information to frame a response to the charge of fraud.

The Ninth Circuit cases cited by petitioners, *Bosse v. Crowell, Collier and MacMillan*, 565 F.2d 602 (9th Cir. 1977) and *Walling v. Beverly Enterprises*, 476 F.2d 393 (9th Cir. 1973), are also consistent with *Ross*, in that they dealt with fraudulent intent rather than with knowledge of a specific fact; thus no necessity for the pleading of specific knowledge existed in those cases.

[3]*United States ex rel. Joseph v. Cannon*, 642 F.2d 1373 (D.C. Cir. 1981) is another case in which the alleged fraudulent transaction was not pleaded with particularity. Plaintiff alleged that members of a Senator's staff, while collecting their government salaries, rendered personal services for the Senator and his family. However, the complaint failed to state which members of the Senator's staff were involved, what services were performed, when the activities occurred, and even whether there was any neglect of official duties. *Id.* at 1385-86.

As indicated above, there is simply no conflict among the circuits as to the meaning of the particularity requirement under Rule 9(b). As will be discussed below, this requirement is nonetheless satisfied by the Summa counterclaims.

C. The Summa Counterclaim Have Satisfied the Rule 9(b) Particularity Requirement.

The Ninth Circuit was correct in finding that Summa has set forth much more than conclusory allegations. It has included the time, place, and nature of many of the alleged wrongful activities, including those supported by information and belief. Each of the counterdefendants is identified, and his or her fiduciary obligations clearly stated. (Petition, Appendix B — hereinafter referred to as "Counterclaims" — ¶¶29-44 at 11-15.) Their individual and collective rise to positions of absolute control over the affairs and finances of Summa and Howard Hughes is closely chronicled. (Counterclaims, ¶¶47-55 at 22-24.) Hughes' drug dependencies and mental disabilities are described, as are the means used by the counterdefendants to exploit those tragic weaknesses. (Counterclaims, ¶45 at 16-22, ¶¶56-84 at 24-37.)

More than mere neutral conduct is alleged. Counterdefendants' abuses of their power over Hughes and his companies are exhaustively detailed (Counterclaims, ¶58 at 29-32). Use of company funds for personal purposes is particularized by date and amount, including, for example, the support and education of children and friends of counterdefendants Gay, Eckersly, Myler, and Holmes, and the improvement of a farm owned by counterdefendant Davis' wife (Counterclaims, ¶¶58(c)(1), 58(c)(6)). These are not neutral acts — the court below properly notes that these alleged activities are wrongful. (Opinion Below at 8).

Contrary to the assertion of petitioners (Petition at 8), other courts of appeals do not prohibit allegations based on

information and belief in all circumstances. Such allegations satisfy the particularity requirement when accompanied by a statement of the facts upon which the belief is founded. *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 379 (2nd Cir. 1974), cert. denied 421 U.S. 976 (1975). This is precisely what Summa has done. Paragraph 57 of the second amended counterclaims sets forth the factual basis for its allegation made on information and belief, referring when appropriate to facts alleged on knowledge elsewhere in the pleading.

In addition, the rule relating to information and belief may be relaxed as to matters particularly within the opposing parties' knowledge. *Schlick, supra; Spiegler v. Wills*, 60 F.R.D. 681, 683 (S.D.N.Y. 1973). This is particularly true when the claimant does not enjoy full information about the manner in which the corporation's internal affairs were conducted. *Id.* The applicability of this standard in the instant case is evident, given the intensely guarded and unique nature of the operations of the Hughes companies prior to Hughes' death (Opinion Below at 8). The court below also correctly notes that less particularity is required when the fraud is directed against a third party, *Allegaert v. Perot*, 78 F.R.D. 427 (S.D.N.Y. 1978), and when the events encompassing the alleged fraud have happened over a lengthy period of time and there are many individuals involved. *In Re Equity Funding Corporation of America Securities Litigation*, 416 F.Supp. 161, 181 (C.D. Cal. 1976); *Temple v. Haft*, 73 F.R.D. 49, 53 (D. Del. 1976). These factors, evident in the instant case, argue for further leniency in the application of the particularity requirement. The court below is thus correct in finding that, even if Rule 9(b) could be viewed as applicable to the instant case, the Summa second

amended counterclaims have met and exceeded the most stringent requirements of particularized pleading (Opinion Below at 6).

D. The Ninth Circuit's Reversal of the Rule 41(b) Dismissal Was Proper.

Petitioners' response to the Ninth Circuit's holding that the use of Rule 41(b) was improper is another exercise in obfuscation dressed up in the jargon of "dismissal on the merits" and "abuse of discretion." (Petition at 8-9.) However, the point — not even addressed by petitioners — is that Rule 41(b) may not be employed to transform a ruling that a pleading is insufficient into the equivalent of a judgment entered after trial. Such a ruling is res judicata as to the sufficiency of the pleading under the Federal Rules — and no more. Another suit based on the same facts, or the same cause of action, is not barred if brought as a sufficient pleading for the simple reason that no facts have been adjudicated. *See, e.g., Costello v. United States*, 365 U.S. 265, 284-88 (1961). No question of discretion enters into it. The Ninth Circuit's reversal of the Rule 41(b) dismissal was thus proper.

Conclusion.

For these reasons, a writ of certiorari should not be issued to review the judgment and memorandum opinion of the Ninth Circuit.

Respectfully submitted,

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